

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:CORP:BR06-PLR-130243-01

Date:

January 10, 2002

### Legend

Corp 1 =

Distributing =

Controlled =

Business 1 =

Business 2 =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Dear

This letter is in reply to your letter dated March 13, 2001, requesting rulings as to the federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated July 31, 2001, August 3, 2001 and August 23, 2001, October 25, 2001, November 19, 2001, and January 10, 2002. The information submitted for consideration is summarized below.

Corp 1 was formed in Year 1. Corp 1 currently conducts Business 1 and Business 2. Corp 1 has been conducting Business 1 since Year 1, and Business 2

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since Year 2. Effective Date 1, Corp 1 filed an election to be taxed as a small business corporation.

Distributing was organized on Date 2 as a limited liability company and is currently taxed as a partnership. Distributing currently has no assets.

Controlled was organized by Distributing on Date 2 as a limited liability company and is currently taxed as a partnership. Controlled currently has no assets.

Corp 1, and Distributing are held in same proportions by the same shareholders/members and are each on the accrual method of accounting.

Distributing currently owns all of the membership interests in Controlled.

Corp 1 will merge into Distributing as described more completely below. Immediately before the merger, Distributing will file Form 8832, Entity Classification Election, to be taxed as a corporation, and Distributing will amend its operating agreement appropriately to reflect the change from a partnership to a corporation. Immediately before the merger, Controlled will file Form 8832, Entity Classification Election, to be taxed as a corporation, and Controlled will amend its operating agreement appropriately to reflect the change from a partnership to a corporation. Corp 1 will merge into Distributing in a transaction which taxpayer represents as qualifying as an F reorganization under section 368(a)(1)(F), or an A reorganization under 368(a)(1)(A). In the merger, Corp 1 will transfer all of Business 1 and Business 2 to Distributing. Distributing will then transfer Business 2 as well as fixed assets and property, plant and equipment used in Business 1 to Controlled in exchange for Controlled membership interests (Because Distributing and Controlled will elect to be taxed as corporations, their membership interests at the time of the election will be deemed to be stock interests for tax purposes.) Distributing will then distribute the Controlled membership interests to Distributing members pro rata. Immediately before the Distribution, Distributing will own all the membership interests in Controlled.

The business reasons for the above mentioned transactions are as follows: (1) To allow Business 2 and certain assets of Business 1 to be completely segregated and insulated from the inherent risks of Business 1. Since Business 1 is a inherently dangerous business, Business 1 could be exposed to a high degree of tort liability from claimants. (2) In addition, after the transaction, Controlled will own certain Business 1 assets and Business 2. The ownership of these assets will enable Controlled to borrow money and to purchase additional Business 1 assets with that money. These Business 1 assets will be leased back to Distributing. Therefore, Distributing will receive the benefit of new Business 1 assets and will be able to continue to expand Business 1.

Immediately after the distribution, Distributing will continue the active business of Business 1 previously carried on by Corp 1. (immediate predecessor to Distributing)

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Immediately after the distribution, Controlled will be directly engaged in Business 2. Immediately after the distribution, Controlled will continue the active business of Business 2. In addition, Controlled will engage in leasing certain real property and equipment back to Distributing at fair market value. Controlled will also be actively engaged in managing the real property and equipment.

The following representations have been made in connection with the proposed transactions:

- (a) No part of the consideration to be distributed by the Distributing corporation will be received by a shareholder as a creditor, employee or in any capacity other than that of a shareholder of the corporation.
- (b) The five years of financial information submitted on behalf of the Distributing corporation is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted. However, following the transaction, Controlled will lease the Business 1 assets received from Distributing back to Distributing.
- (c) Following the transaction, the Distributing and Controlled corporations will each continue the active conduct of its business, independently and with its separate employees. However, following the transaction, Controlled will lease the Business 1 assets received from Distributing back to Distributing.
- (d) The distribution of the stock, or stock and securities, of the Controlled corporation is carried out for the following corporate business purposes. (1) To allow Business 2 and certain assets of Business 1 to be completely segregated and insulated from the inherent risks of Business 1. Since Business 1 is an inherently dangerous business, Business 1 could be exposed to a high degree of tort liability from claimants. (2) In addition, after the transaction, Controlled will own certain Business 1 assets and Business 2. The ownership of these assets will enable Controlled to borrow money and to purchase additional Business 1 assets with that money. These Business 1 assets will be leased back to Distributing. Therefore, Distributing will receive the benefit of new Business 1 assets and will be able to continue to expand Business 1. The distribution of stock, or stock and securities, of the Controlled corporation is motivated, in or whole or substantial part, by one or more of these corporate business purposes.
- (e) There is no plan or intention by the shareholders or security shareholders

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of the Distributing corporation to sell exchange, transfer by gift, or otherwise dispose of any of their stock in, or securities of, either the Distributing or Controlled corporation after the transaction.

- (f) There is no plan or intention by either the Distributing corporation or the Controlled corporation, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of section 4.05(1)(b) of Rev. proc. 96-30.
- (g) There is no plan or intention to liquidate either the Distributing or Controlled corporation, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation after the transaction, except in the ordinary course of business.
- (h) The income tax liability for the taxable year in which investment credit property (including any building to which § 47(d) applies) is transferred will be adjusted pursuant to §50(a)(1) or (a)(2) (or §47, as in effect before amendment by Public Law 101-508, Title 11, 104 Stat. 1388, 536 (1990), if applicable) to reflect an early disposition of property.
- (i) The Distributing corporation neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of this transaction.
- (j) No intercorporate debt will exist between the Distributing corporation and the Controlled corporation at the time of, or subsequent to, the distribution of the Controlled corporation stock.
- (k) Payments made in connection with all continuing transactions, if any, between the Distributing and Controlled corporations, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.
- (l) No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv)
- (m) The Distributing corporation is not an S corporation ( within the meaning of §1361(a)), but immediately before the distribution, the Distributing corporation will be eligible to make an S corporation election pursuant to §1362(a). The Distributing and Controlled corporations will each elect to be an S corporation pursuant to §1362(a) on the first available date after the distribution, and there is no plan or intent to revoke or otherwise terminate the S corporation election of either the Distributing or Controlled

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corporation.

- (n) The distribution is not part of a plan or series of related transactions (within the meaning of §355(e)) pursuant to which one or more persons will acquire directly or indirectly, stock possessing 50 percent or more of the total combined voting power of all classes of Distributing or Controlled common stock entitled to vote or 50 percent or more of the total value of shares of all classes of Distributing or Controlled common stock.
- (o) For purposes of Section 355(d), immediately after the distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Distributing stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Distributing stock, that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.
- (p) For purposes of Section 355(d), immediately after the distribution, no person (determined after applying Section 355(d)(7)) will hold stock possessing 50 percent or more of the total combined voting power of all classes of Controlled stock entitled to vote, or 50 percent or more of the total value of shares of all classes of Controlled stock, that was either (i) acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date, or (ii) attributable to distributions on Distributing stock that was acquired by purchase (as defined in Section 355(d)(5) and (8)) during the five-year period (determined after applying Section 355(d)(6)) ending on the distribution date.
- (q) Prior to the proposed transaction, Controlled will file a Form 8832, Entity Classification Election to be taxed as a corporation, effective the date of the transaction, and Controlled will amend its operating agreement appropriately to reflect the change from a partnership to a corporation.
- (r) The merger of Corp 1 into Distributing will constitute a transaction under Section 368(a)(1)(F).
- (s) The merger of Corp 1 into Distributing will also constitute a transaction under Section 368(a)(1)(A).
- (t) Prior to the proposed transaction, Distributing will file a Form 8832, Entity Classification Election to be taxed as a corporation, effective the date of the transaction, and Distributing will amend its operating agreement

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appropriately to reflect the change from a partnership to a corporation.

- (u) Distributing and Controlled will each elect to be an S corporation pursuant to section 1362(a) by filing a Form 2553, Election by Small Business Corporation immediately after the distribution.
- (v) (i) The total adjusted basis and the fair market value of the assets transferred to the Controlled corporation by the Distributing corporation each equals or exceeds the sum of the liabilities assumed by the Controlled corporation plus any liabilities to which the transferred assets are subject; and (ii) The liabilities assumed in the transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

Based solely on the information submitted and on the representations set forth above, we hold as follows:

- (a) The merger of Corp 1 into Distributing will constitute a reorganization under I.R.C. § 368(a)(1)(F). See Rev. Rul. 69-516, 1969-2 C.B. 51, Rev. Rul. 96-29, 1996-1 C.B. 50.
- (b) The merger of Corp 1 into Distributing will not terminate Corp 1's election to be taxed as a small business corporation.
- (c) That the transfer of assets ("Contributed Assets") by Distributing to Controlled, followed by the distribution by Controlled to Distributing of Controlled ownership interests will qualify as a reorganization within the meaning of I.R.C. 368(a)(1)(D). That Distributing and Controlled will each be a "party to a reorganization" within the meaning of Section 368(b).
- (d) That no gain or loss will be recognized by Distributing upon the transfer of the Contributed Assets to Controlled in exchange for Controlled membership interests. Section 361(a).
- (e) That no gain or loss will be recognized by Controlled upon the receipt of assets in actual or constructive exchange for Controlled ownership interests pursuant to I.R.C. section 1032.
- (f) That no gain or loss shall be recognized by Distributing upon the distribution of Controlled ownership interests to Distributing's membership holders pursuant to IRC section 361(c)(1).

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- (g) The basis of the Contributed Assets received from Distributing pursuant to the contribution in the hands of Controlled immediately after the proposed transaction will be the same as the basis of such assets in the hands of Distributing immediately before the proposed transaction. Section 362(b)
- (h) The holding period of the Contributed Assets received from Distributing pursuant to the contribution in the hands of Controlled will include the period during which Distributing held the contributed assets. Section 1223(2).
- (i) No gain or loss will be recognized (and no amount will be included in the income of) the Distributing membership holders upon their receipt of membership interests in Controlled in the distribution. Section 355 (a)(1).
- (j) The aggregate basis of the ownership interests in Controlled and Distributing in the hands of the Distributing membership owners after the distribution will be the same as the aggregate basis of membership ownership interests in Distributing immediately before the distribution and will be allocated among membership ownership interests of Distributing and Controlled in proportion to their relative fair market value in accordance with Section 358(a), (b)(2) and (c) and Section 1.358-2(a)(2) of the regulations.
- (k) The holding period of the Controlled membership ownership interests received by each Distributing membership owner in the distribution will include the period during which the Distributing membership owners held their membership interests in Distributing provided that such membership interests in Distributing are held as a capital asset on the date of the distribution. Section 1223(1).
- (l) As provided in Section 312(h), proper allocation of earnings and profits between Distributing and Controlled will be made in accordance with Section 1.312-10(a) of the regulations.

We express no opinion concerning whether the merger of Corp 1 into Distributing will constitute a reorganization under Section 368(a)(1)(A).

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not directly covered by the above rulings.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. A copy

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of this letter should be attached to the federal income tax returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon the facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the request for the ruling. Verification of the factual information, representations, and other data may be required as part of the audit process.

Sincerely yours,

Alfred C. Bishop, Jr.

Alfred C. Bishop, Jr.  
Branch Chief, Branch 6  
Office of Associate Chief Counsel  
(Corporate)

cc: